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## ENFORCEMENT OF FORFEITURE PROVISIONS AS A REMEDY IN LAND SALE CONTRACTS

By FREDERICK W. FLOWERS\*

USE of the forfeiture provision in a land sale contract as a possible remedy for an unpaid vendor, in his position as a creditor for the purchase price, appears futile in California today. The ancient maxim that "equity abhors a forfeiture"<sup>1</sup> has been sustained in the recent decision of *Kay v. Kay*.<sup>2</sup> In that case the plaintiffs, as vendors under a contract for the sale of land, sought equitable relief by way of an action to quiet title to real property and to order defendants to quit and vacate the premises.

The parents (plaintiffs) had purchased the real estate to supply a home for their son and his wife (defendants). A contract was entered into between the plaintiffs and defendants providing for payment in monthly installments. The defendants also agreed to pay all taxes assessed against the property, and to keep the improvements insured. The agreement further provided that if the defendants failed for a period of three months to pay any of the sums agreed upon, or failed to comply with any of the covenants, then the plaintiffs should be released from all legal or equitable obligations to convey the property, and the purchasers would forfeit all rights thereto and any and all payments theretofore paid were to be considered as rent for the use and occupancy of the premises. Time was stated to be of the essence of the agreement.

The defendants were tenants in possession of the premises for two years prior to the making of the contract, and the rent paid had been credited as a down payment under the agreement. As provided, the monthly payments were first used to retire a mortgage held by a bank on the property. Thereafter the payments were to be made directly to the plaintiffs.

Once the lien held by the bank was satisfied, the defendants then owed the plaintiffs approximately seventy per cent of the total purchase price. However no payments were made or tendered thereafter, and no demand for payment was ever made by plaintiffs. It was found that

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<sup>1</sup> "It is a universal rule in equity never to enforce either a penalty or forfeiture." 2 STORY, EQUITY JURISPRUDENCE § 1319 at 564 (13th ed. 1886) and cases cited.

<sup>2</sup> 188 Cal. App. 2d 214, 10 Cal. Rptr. 196 (1961).

the purchasers failed to obtain insurance upon the premises, and that the taxes assessed against the property were not paid for one year. The installment payments were in default for almost two years when plaintiffs notified defendants in writing of their default and, in compliance with the terms of the agreement, gave notice to vacate the premises. Defendant daughter-in-law, who had obtained an interlocutory divorce from co-defendant husband, gave a return notice to plaintiffs setting forth the facts that she was ready and willing to perform, but did not know the exact amount due, and offered to tender that amount, whatever it was, in exchange for a deed. Plaintiffs made no reply to this offer but immediately thereafter brought action to quiet title to the property in question. Upon these findings the trial court entered judgment decreeing that defendant forfeit and vacate the premises and that plaintiffs' title to the property be quieted.

The District Court of Appeal held that the trial court, sitting as a court of equity, should have determined the amount owed the vendors, including any special damages for delay, and should have fixed a reasonable time within which defendant could pay such amount and take the deed to the realty or be strictly foreclosed.

The decision of the District Court of Appeal was not based on a finding of a waiver on the part of the vendors. The court stated that it could not say, as a matter of law, that there had been a waiver; for there might be an excuse for the long period of silence and inaction which would obviate a finding of an intentional waiver of the right to declare the contract terminated for breach; that is, forbearance rather than the intentional relinquishment of the contract right.<sup>3</sup>

Therefore, for its decision, the court relies on equitable principles as set out in *Keller v. Lewis*:<sup>4</sup>

[E]quity frequently interposes to prevent the enforcement of a forfeiture at law. In the view of a Court of Equity, in cases like the present, the legal title is retained by the vendor as security for the balance of the purchase money, and if the vendor obtains his money and interest he gets all he expected when he entered into the contract. True, he is not bound to wait indefinitely after the failure of the purchaser to comply with the terms of his agreement. If the payments are not made when due, he may, if out of possession, bring his ejectment and recover the possession; but if he comes into equity for relief, his better remedy, in case of persistent default on the part of the vendee, is to institute

<sup>3</sup> Mere lapse of time does not amount to a waiver. *Ross v. Gentry*, 94 Cal. App. 742, 744-45, 271 Pac. 1098, 1099 (1928).

<sup>4</sup> 53 Cal. 113, 118 (1878). Note, however, that time was not of the essence in the *Keller* case. The defendants claimed, "that as time was not made of the essence of the contract, the case must be decided in our favor." It was. See also *Hansborough v. Peck*, 72 U.S. (5 Wall.) 497 (1866).

proceedings to foreclose the right of the vendee to purchase; the decree usually giving the latter a definite time within which to perform.

### *Time of the Essence and Section 3275*

The doctrine applied in the *Kay* case was firmly established in California in the leading case of *Barkis v. Scott*,<sup>5</sup> which stated that California Civil Code section 3275 will apply even though "time is of the essence" and there has been no waiver on the part of the vendor.<sup>6</sup> *Barkis* thereby finally brought certainty in California to the field of relief from forfeiture clauses in land purchase contracts which had been in an indefinite state<sup>7</sup> since the decision in *Glock v. Howard & Wilson Colony Co.* in 1898.<sup>8</sup> The *Glock* case held that "where time is expressly made the essence of the contract, equity will not ignore the provision, for equity follows the law, and will neither make a new contract for the parties nor violate that which they have freely and advisedly entered into."<sup>9</sup> In *Barkis*, the court concluded that California Civil Code section 3275 is not precluded by section 1492<sup>10</sup> when there has been substantial part performance of the contract and defendants have raised the question of their right to relief under section 3275.

The *Barkis* case resolved the dispute between California Civil Code section 3275, on the one hand, and the ruling of the *Glock* case, and

<sup>5</sup> 34 Cal. 2d 116, 208 P.2d 367 (1949).

<sup>6</sup> Section 3275 provides: "Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty."

<sup>7</sup> For cases that would enforce forfeiture provisions provided there had been no waiver, see *Boone v. Templeman*, 158 Cal. 290, 110 Pac. 947 (1910); *Fickbohn v. Knaust*, 103 Cal. App. 443, 284 Pac. 692 (1930); *Troughton v. Eakle*, 58 Cal. App. 161, 208 Pac. 161 (1922); *McDonald v. Kingsbury*, 16 Cal. App. 244, 116 Pac. 380 (1911). For cases that would grant or deny relief on the basis of time being of the essence, see *Gonzalez v. Hirose*, 33 Cal. 2d 213, 200 P.2d 793 (1948); *Leslie v. Federal Finance Co. Inc.*, 14 Cal. 2d 73, 92 P.2d 906 (1939); *Henck v. Lake Hemet Water Co.*, 9 Cal. 2d 136, 69 P.2d 849 (1937); *Hopkins v. Woodward*, 216 Cal. 619, 15 P.2d 499 (1932); *Ebbert v. Mercantile Trust Co.*, 213 Cal. 496, 2 P.2d 776 (1931). For cases where, though no time of the essence provision appears, a forfeiture of payments was nevertheless enforced, see *Tuso v. Green*, 194 Cal. 574, 229 Pac. 327 (1924); *Tomboy Gold & Copper Co. v. Marks*, 185 Cal. 336, 197 Pac. 94 (1921); *Cross v. Mayo*, 167 Cal. 594, 140 Pac. 283 (1914); *Jensen v. Corning Farms Co.*, 49 Cal. App. 681, 194 Pac. 83 (1920).

<sup>8</sup> 123 Cal. 1, 58 Pac. 716 (1898).

<sup>9</sup> *Id.* at 9, 55 Pac. at 716.

<sup>10</sup> Section 1492 provides: "Where delay in performance is capable of exact and entire compensation, and time has not been expressly declared to be of the essence of the obligation, an offer of performance, accompanied with an offer of such compensation, may be made at any time after it is due, but without prejudice to any rights acquired by the creditor, or by any other person, in the meantime."

the so-called "freedom to contract,"<sup>11</sup> on the other. In the *Barkis* case the Supreme Court made a very thorough analysis of the authorities bearing on this question and said:<sup>12</sup>

On the other hand, when the default has not been serious and the vendee is willing and able to continue with his performance of the contract, the vendor suffers no damage by allowing the vendee to do so. In this situation, if there has been substantial part performance or if the vendee has made substantial improvements in reliance on his contract, permitting the vendor to terminate the vendee's rights under the contract and keep the installments that have been paid can result only in the harshest sort of forfeitures. Accordingly, relief will be granted whether or not time has been made of the essence.

The *Barkis* decision has been followed by a number of cases,<sup>13</sup> and one may perhaps wonder why neither it, nor section 3275 of California Civil Code, was cited as controlling in *Kay v. Kay*, although the court did rely in part on the holding of *Scarbery v. Bill Patch Land & Water Co.*,<sup>14</sup> which followed section 3275 and *Barkis*. However, in *Kay* the same result was reached on the basis of the same reasoning, so that it secures to the purchaser, in land installment-purchase contracts, an even more advantageous position in regards to a forfeiture clause.

### *Application of the Doctrine Against Forfeitures*

California cases have held that equity will grant relief from forfeiture to a purchaser if the purchaser's breach is found not to be grossly negligent,<sup>15</sup> willful,<sup>16</sup> or fraudulent.<sup>17</sup> In *Kay*, the purchasers were in default for approximately two years and never made an inquiry as to the amount due nor a tender of payment. Since section 3275 of California Civil Code presupposes that the party seeking relief from

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<sup>11</sup> CAL. CIV. CODE § 1636 which provides: "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful."

<sup>12</sup> 34 Cal. 2d at 122, 208 P.2d at 371.

<sup>13</sup> *E.g.*, *Bird v. Kenworthy*, 43 Cal. 2d 656, 277 P.2d 1 (1954); *Royer v. Carter*, 37 Cal. 2d 544, 233 P.2d 539 (1951); *Norris v. San Mateo County Title Co.*, 37 Cal. 2d 269, 231 P.2d 493 (1951); *Freedman v. The Rector*, 37 Cal. 2d 16, 230 P.2d 629 (1951); *Baffa v. Johnson*, 35 Cal. 2d 36, 216 P.2d 13 (1950); *Nelson v. Dangerfield*, 125 Cal. App. 2d 146, 269 P.2d 953 (1954); *Major-Blakeney Corp. v. Jenkins*, 121 Cal. App. 2d 325, 263 P.2d 655 (1953); *Furst v. Scharer*, 119 Cal. App. 2d 605, 260 P.2d 198 (1953); *Crofoot v. Weger*, 109 Cal. App. 2d 839, 241 P.2d 1017 (1952).

<sup>14</sup> 184 Cal. App. 2d 87, 7 Cal. Rptr. 408 (1960).

<sup>15</sup> *Sawyer v. Sterling Realty Co.*, 41 Cal. App. 2d 715, 107 P.2d 449 (1940) (failure for over 3 years to pay anything on contract, not even sufficient to cover taxes, showed gross negligence).

<sup>16</sup> *Baffa v. Johnson*, 35 Cal. 2d 36, 216 P.2d 13 (1950).

<sup>17</sup> *Palmer v. McArthur*, 99 Cal. App. 510, 278 Pac. 1049 (1929).

forfeiture is in default,<sup>18</sup> the issue of his right to relief from the forfeiture is not adequately answered by a finding that the purchaser was in long continued default. The court must rule at least that the purchaser was willful or grossly negligent or fraudulent before denying him relief.<sup>19</sup> A willful breach of obligation is construed to mean a voluntary breach of obligation.<sup>20</sup> "Willful" within California Civil Code section 3275 means voluntary, spontaneous, intentional, or designed.<sup>21</sup> In *Kay*, the trial court found that no evidence had been produced by the purchasers to explain or justify their breach of contract and their default in making payments as required. Was this breach willful? The court does not say.

Had the contract been completed by defendants, plaintiffs would have received a little over \$7,750. By enforcement of the forfeiture clause, the plaintiffs would have retained the payments of \$2,700 made up to the time of default. Applying the \$2,700 over the eight-year period the defendants were in possession, they would have paid a monthly rental of less than \$30. But if plaintiffs had rented the premises for the period defendants had possession, for the same amount the premises were rented out by defendants to third parties for a portion of the time (\$85 per month), they would have earned \$8,160 in rentals. The purpose of the policy against forfeitures is to prevent unconscionable inequities; but where the vendor would have received greater benefit if the property had remained in his possession than the amount that would be obtained by him because of the forfeiture, would there be inequity? It would seem not.<sup>22</sup> The vendor would not have been unjustly enriched if he had been allowed to keep the land and the payments received by him. Nor would the purchaser have suffered an unjust detriment if payments theretofore paid were considered as rent for the use and occupancy of the premises.

In general, courts of equity refuse to aid in the enforcement of penalties and forfeitures. While some authorities have stated this as an inflexible rule, other authorities have held that the rule will yield where the equities require it to.<sup>23</sup> The doctrine of the early common

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<sup>18</sup> *Beck v. Combs*, 169 Cal. App. 2d 583, 337 P.2d 505 (1959); *Lucientes v. Bliss*, 157 Cal. App. 2d 565, 321 P.2d 526 (1958); *Bolln v. Petrocchi*, 95 Cal. App. 2d 589, 213 P.2d 513 (1950); *Amoruso v. Carley*, 93 Cal. App. 2d 422, 209 P.2d 139 (1949); *Kammerer v. Woodson*, 93 Cal. App. 2d 220, 208 P.2d 372 (1949).

<sup>19</sup> *Beck v. Combs*, 169 Cal. App. 2d 583, 337 P.2d 505 (1959).

<sup>20</sup> *Taylor v. U.S. Fidelity & Guarantee Co.*, 86 Cal. App. 382, 260 Pac. 898 (1927).

<sup>21</sup> *Wilson v. Security-First Nat. Bank*, 84 Cal. App. 2d 427, 190 P.2d 975 (1948); *Crowell v. City of Riverside*, 26 Cal. App. 2d 566, 80 P.2d 120 (1938).

<sup>22</sup> See *Bird v. Kenworthy*, 43 Cal. 2d 656, 277 P.2d 1 (1954).

<sup>23</sup> 30 C.J.S. *Equity* § 57, at 398 (1942).

law was an inflexible rule holding the parties to strict performance of all the covenants of their contracts. Whenever, therefore, a contract provided for a penalty or a forfeiture, the full penalty or forfeiture would be enforced by a court of law without the slightest regard to the amount of damages actually suffered by the vendor as a result of the default.<sup>24</sup>

In most of the United States, it is settled law that a court of equity will not enforce a time-of-the-essence clause, but that it will, as in *Kay*, give the purchaser what he bargained for, despite his breach of condition, if he is ready to perform and tenders payment within a stated time. The condition is treated as a provision for the purpose of securing performance, with the vendor receiving full compensation for the delay by way of damages. But the court refuses to enforce the forfeiture of the purchaser's equitable estate which would result at law.<sup>25</sup> "That this position is sound and just, and is in accord with the entire history of equitable relief against forfeitures where the breach causing the forfeiture is mere delay in paying money easily compensated by awarding interest, is too clear for argument."<sup>26</sup> It would thus seem that the insertion of the phrase, "time is of the essence," makes little, if any, difference when resort must be had to the courts for enforcement of a forfeiture clause.

Whether equity will interfere to prevent forfeiture is determined by whether compensation can adequately be made for a breach of the condition. If the penalty is merely to secure the payment of money, then compensation can always be made, and a court of equity will relieve the purchaser of the forfeiture upon his payment of the principal and interest.<sup>27</sup> As stated by Pomeroy:<sup>28</sup>

The granting of relief in such circumstances is based on the ground that it is wholly against conscience to say that because a man has stipulated for a penalty in case of his omission to do a particular act—the real object of the parties being the performance of the act—if he omits to do the act, he shall suffer a loss which is wholly disproportionate to the injury sustained by the other party.

It can be said that California Civil Code section 3369 is a codification of the equitable principles involved. That section provides that

<sup>24</sup> See 2 POMEROY, EQUITY JURISPRUDENCE § 381, at 45 (5th ed. 1941).

<sup>25</sup> *Cheney v. Libby*, 134 U.S. 68 (1890); *Butler v. Colson*, 99 Ark. 340, 138 S.W. 467 (1911); *Steele v. Branch*, 40 Cal. 3 (1870); *Jones v. Robbins*, 29 Me. 351 (1849); *Barnard v. Lee*, 97 Mass. 92 (1867); *Richmond v. Robinson*, 12 Mich. 193 (1864); *O'Fallen v. Kennerly*, 45 Mo. 124 (1869); *Hall and Rawson v. Delaplaine*, 5 Wis. 206 (1856). See WALSH, EQUITY § 4 at 18 (1930).

<sup>26</sup> WALSH, EQUITY § 74 at 374-75 (1930).

<sup>27</sup> *Bell v. Scranton Coal Mines Co.*, 59 Wash. 659, 110 Pac. 628 (1910).

<sup>28</sup> 2 POMEROY, EQUITY JURISPRUDENCE § 433, at 207 (5th ed. 1941).

"Neither specific nor preventive relief can be granted to enforce a penalty or forfeiture in any case. . . ."

With respect to the amount of damages suffered by the vendor, it is proper to consider that the land was off the market for a time, that no interest was paid, that added taxes fell due, and similar factors.<sup>29</sup>

### *The Freedom to Contract Argument*

But what about the doctrine of freedom to contract? Shouldn't parties be able to agree on the terms of a contract for the sale of real estate and be able to resort to the courts to have the provisions enforced? There is no doubt that a limit has been placed upon the much prized freedom of contract, and yet the courts have not gone so far to hold such express conditions for forfeiture to be contrary to public policy.<sup>30</sup> As put by Professor Corbin:<sup>31</sup>

When it is said that courts do not favor forfeitures, the meaning is that they do not like to see a party to a contract getting something for nothing. . . . Therefore, the courts do not greatly favor express conditions precedent where the condition is itself no part of the subject-matter of exchange by the parties and where giving effect to the condition will result in one of the parties enjoying benefits under the contract without giving the agreed equivalent in exchange therefor.

It is true, however, in the reality of the business world, that parties who contract for the sale of land are often not dealing on an equal basis; so the law should help the vendee protect himself. In most cases involving the sale of real property, it is the vendor who draws the contract, with covenants and conditions carefully worked out to safeguard his interests, and he presents it to a purchaser with little or no business experience. This is particularly true in cases of large corporations and even individuals subdividing large tracts of land for sale to the public. The vendor is thus armed with a power which could be exercised unfairly, and the law ought not permit him to enforce harsh forfeiture provisions without a balancing of the equities. To be sure, freedom to contract has its justifiable limitations.<sup>32</sup>

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<sup>29</sup> *Major-Blakeney Corp. v. Jenkins*, 121 Cal. App. 2d 325, 263 P.2d 655 (1953); *Sawyer v. Sterling Realty Co.*, 41 Cal. App. 2d 715, 107 P.2d 449 (1940) (purchaser failed to establish that his down payment exceeded vendor's damages under the contract).

<sup>30</sup> See UNIFORM COMMERCIAL CODE § 2-302 which provides: "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

<sup>31</sup> 3A CORBIN, CONTRACTS § 748 at 465 (1960).

<sup>32</sup> See Vanneman, *Strict Foreclosure on Land Contracts*, 14 MINN. L. REV. 342 (1930).

### Conclusion

So what may a vendor do to insure that payments will be made on time, and also that the law will not be "making a new contract for the parties"? Strict enforcement of a forfeiture clause, in the absence of fraud, willfulness, gross negligence, and the like, may be practically impossible in California today. However, some rather sweeping generalities may be suggested. The contract must be perfectly fair,<sup>33</sup> just, and equal in its terms and in its circumstances. The reasons the parties desire an exact performance should be stated to show that a breach, which in normal circumstances would be immaterial, is material in the particular case. This suggestion may suffice to meet the objections based upon section 302 of the *Restatement of Contracts*.<sup>34</sup> The contract must not be one-sided, or unconscionable. Its enforcement must not be hard on the purchaser. It must not have been obtained by the vendor by trickery, or by taking undue advantage of his position, or by failing to disclose any material facts. In other words, for the vendor to come to equity he must come into court with clean hands, and the contract should so indicate.<sup>35</sup>

And where has the *Kay* case left the vendor? Perhaps the California courts should go a little further in taking his position into consideration. It is of utmost importance that contracts between parties be certain and fixed, and that each party shall know exactly when he is bound and when he is not. This is especially true in contracts dealing with the sale of land. The one thing certain for the vendor of real property, under the holding of the *Kay* case, is that his position, in regards to a forfeiture clause agreed upon by both parties, is now even more uncertain, albeit all of the dealings were on an equal and fair basis. It would seem that other purchasers are thus encouraged to breach their obligations when it would appear profitable or convenient to do so, for they may still be able to secure title.

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<sup>33</sup> And yet in the *Kay* case, how much more fair could the condition be of allowing the purchaser three months in which to make a defaulted payment, before the forfeiture provision was to take effect? It is to be noted that most contracts of this type do not provide for any such time lag—especially when time has been made of the essence.

<sup>34</sup> Note, 37 CALIF. L. REV. 498, 505 (1949). Section 302 provides: "A condition may be excused without other reason if its requirement (a) will involve extreme forfeiture or penalty, and (b) its existence or occurrence forms no essential part of the exchange for the promisor's promise."

<sup>35</sup> See 4 POMEROY, EQUITY JURISPRUDENCE § 1405a (5th ed. 1941). See also *Curran v. Holyoke Water Power Company*, 116 Mass. 90 (1874).